

# New year, new opportunities

✓ **As the economic recovery gathers pace around the globe, risk assets are likely to emerge as the stars of 2021**

**T**he pandemic is clearly far from over, but we enter 2021 with relative optimism. We expect the economic recovery to be rapid; manufacturing and global trade are already rebounding substantially. Lockdowns are keeping many services at bay, but those too are ready to go when they have the greenlight. Consumer balance sheets are healthy given the support they have received; corporates too have not seen capital this cheap ever before.

As the vaccine rolls out and economic activity bursts into life, the recovery will likely be most potent through the summer and autumn. The final months of the year may prove more challenging, with the onus to prove the longevity of the vaccine immunity through next winter.

What does that all mean for the investment landscape? In general, I would expect less volatility than we saw in 2020, but great divergence between asset classes, sectors and industry groups. That creates interesting opportunities for active managers.

## Follow the cycle

As the recovery gathers pace, we favour assets that derive returns from improving economic activity, and cyclical sectors of the economy. Consumer discretionary, metals and mining and industrials are all likely to do well. As we see a rotation into value cyclicals, the tech sector may struggle to repeat its runaway success of 2020, which, in turn, may reduce the dominance of the tech-heavy US market.

The pro-cyclical tilt could benefit the UK market, given that Brexit is now done

and that British large caps are heavily weighted towards energy, materials and financials. It also opens the door to more broad-based strength in emerging markets, with gains in commodities potentially helping Russia and Latin America.

In Europe, we like consumer names – premium brands, high-end consumer companies. Domestic demand remains problematic in the face of uncertainties of the German election, the continued debate about the degree of integration and the possibility of another political crisis in Italy.

Overall, we expect global equity returns to be above their long-term average, delivering 7-10 per cent for the year.

As we find equity attractive, so should corporates themselves. There should be more mergers and acquisitions in this environment, indeed we've already seen a notable pick-up.

Commodity prices have already risen meaningfully over the past six months and we forecast further gains as demand increases. The weakness of the US dollar will further improve the attractiveness of non-US assets, including those in emerging markets, where economic growth already has a tailwind. China's pledge to keep its economic policy stable gives more comfort around the trajectory of world economic growth next year.

The fixed income market remains a licence to lose money, certainly in real terms. Corporate credit spreads are already narrow globally at below 100bps for investment grade credit (though wider in the UK). At these levels we don't think they offer enough compensation



for potential default risks and for the slow and steady rise in nominal interest rates.

One area of the debt universe where we do see opportunities is inflation-linked bonds.

Inflation isn't a threat for today or tomorrow, but it will come. We are already seeing stronger commodity prices and some bottle necks in terms of supply across a number of sectors due to Covid-related disruptions. That will at some point lead to inflationary pressures. The question is whether we will see one-off price changes, or whether they will be met with demand for higher salaries and higher pay? The latter would mean a more extended inflationary threat.

A lot depends on governments too. Will they invest to improve long-term growth potential or opt instead for popular redistribution to satisfy short-term, such as higher minimum wages? Will the push for a greener economy be done primarily through regulation or through investment? As countries pick their paths, the divergence between economies may become much greater than in the past decade.

Whatever happens, we believe that assets with real claims to the economy should outperform – corporate profits via equities, real assets like gold and commodities, and index- or inflation-linked bonds.



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